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No. 85-1546

In the Supreme Court of the United States

OCTOBER TERM, 1985

MID-STATE HOMES, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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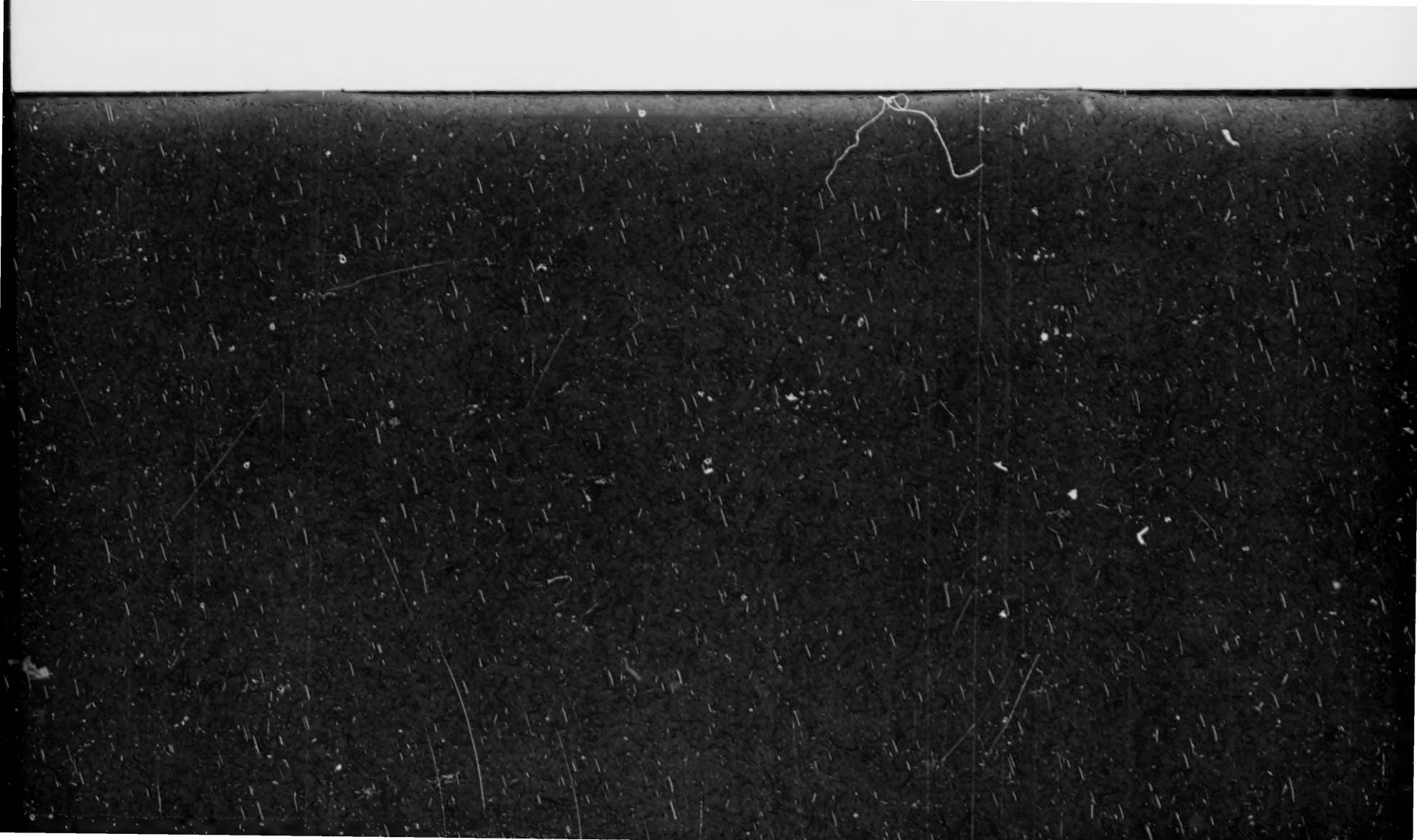

TABLE OF AUTHORITIES

Page

Cases:

Baldwin County S&L Ass'n v. *United States*, 81-2 U.S. Tax Cas. (CCH) ¶ 9619 ..... 5, 7

Baum v. *United States*, 76-1 U.S. Tax Cas. (CCH) ¶ 9208 5

Gilliland v. *United States*, 47 A.F.T.R.2d (P-H) ¶ 81-589 5

Little v. *United States*, 709 F.2d 517 5

Mobley v. *Brundidge Banking Co.*, 347 So.2d 1347 7

Muscle Shoals Nat'l Bank v. *Hallmark*, 399 So.2d 297 7

Myers v. *United States*, 647 F.2d 591 5

Oden v. *King*, 216 Ala. 504, 113 So. 609 7

Puls v. *United States*, 387 F. Supp. 760 5

Trauner v. *Lowrey*, 369 So.2d 531 7

United States v. *Brosnan*, 363 U.S. 237 4

Statutes:

Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 109, 80 Stat. 1141 4

Page

Statutes—Continued:

Internal Revenue Code of 1954 (26 U.S.C.):

§ 6331(a) 2

§ 7425 ..... 2, 3, 4, 5, 6

§ 7425(b)(1) 2, 3, 4, 6

§ 7425(c)(1) 2

Miscellaneous:

H.R. Rep. 1884, 89th Cong., 2d Sess. (1966) 5

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Petitioner challenges the court of appeals' holding that its interest as a purchaser at a nonjudicial foreclosure sale held without notice to the United States is subject to a federal tax lien. The decision below is correct. Petitioner does not allege, nor is there, a conflict among the circuits on the question presented. There is no basis for further review.

1. In October 1972, taxpayers Manuel Ferguson and his wife executed a mortgage on Alabama realty (Pet. App. A6). The mortgage was later assigned to petitioner Mid-State Homes (*id.* at A7). In November 1979, the IRS made an asssessment of unpaid taxes against the Fergusons in the amount of $8,580 (*ibid.*). The IRS properly filed, on July 17, 1980, a notice of tax lien in that amount against the Fergusons' property (*ibid.*).

The Fergusons subsequently defaulted on their mortgage. On December 30, 1981, in accordance with the power of sale contained in the mortgage, petitioner conducted a nonjudicial foreclosure sale of the property (Pet. App. C6). Petitioner, however, failed to give the United States notice of the sale, as required by Section 7425(c)(1) of the Internal Revenue Code.[1] That Section provides that notice of a nonjudicial sale of property on which the IRS has a tax lien "shall be given * * * in writing * * * not less than 25 days prior to such sale, to the Secretary [of the Treasury]." Section 7425(b)(1) in turn provides that, if the IRS is not properly notified of a nonjudicial foreclosure sale, the sale "shall * * * be made subject to and without disturbing such lien." Petitioner purchased the Fergusons' property at the foreclosure sale for $12,543 (Pet. App. C7 & n.4).

Apparently recognizing that its foreclosure sale was ineffectual against the United States because of its failure to give the notice required by Section 7425, petitioner conducted another foreclosure sale of the same property about 11 months later (Pet. App. C7 & n.5). This time, petitioner gave notice of the sale to the United States. Petitioner once again purchased the property at the foreclosure sale (*id.* at A7-A8).

Section 6331(a) of the Code authorizes the IRS to collect an unpaid tax "by levy upon all property and rights to property * * * on which there is a lien * * * for the payment of such tax." On April 22, 1983, the IRS endeavored to collect the Fergusons' unpaid tax by levying on the property that petitioner had purchased at the foreclosure sale (Pet. App. A8). After the IRS took possession of the realty, petitioner brought this wrongful levy action in the district

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[1]Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

court, seeking return of the property and contending inter alia that Section 7425 was unconstitutional (Pet. App. C12).

The district court entered summary judgment for petitioner (Pet. App. A1-A14). It held that "Mid-State's second foreclosure was successful in cutting off [the government's] tax lien, leaving [the government] with no more than a lien creditor's statutory right to redeem" (*id.* at A9). The court gave the government 30 days either to redeem the property or to relinquish possession (*id.* at A14).

The court of appeals unanimously reversed (Pet. App. C1-C42). It held that, since petitioner failed to notify the IRS of the first foreclosure sale, the plain language of the statute dictated that the sale was "made subject to and without disturbing" the federal tax lien (I.R.C. § 7425(b)(1)). Under Alabama law, the court continued (Pet. App. C25-C29), the result of petitioner's purchase of the property at the first foreclosure sale was to extinguish both the Fergusons' mortgage indebtedness and petitioner's mortgage lien, in effect "merging" the equity of redemption (previously held by the Fergusons) and the legal title (previously held by petitioner). By virtue of this "complete merger of title" (*id.* at C28), the first foreclosure sale vested petitioner with "fee simple title to the property," title that was "superior to all liens except those not extinguished, such as * * * [the] federal tax lien," which survived as a claim against the property on account of petitioner's noncompliance with Section 7425(b)(1). Since petitioner acquired a fee simple interest by virtue of the first foreclosure sale, the court concluded, "it was impossible for [petitioner] to conduct a second correcting foreclosure sale," and thus extinguish the federal tax lien, by purporting to sell to itself, some 11 months later, property that it already owned (Pet. App. C29).

The court of appeals acknowledged that the effect of its holding was to elevate the federal tax lien from its junior status and make it a senior claim against the property (Pet. App. C29). The court explained, however, that this was the natural and inevitable result of petitioner's failure to notify the IRS of the sale, as required by Section 7425, and the merger of title under Alabama law, under which the foreclosure sale extinguished petitioner's senior lien and converted that lien into a fee simple interest. The court rejected petitioner's argument that this result was "harsh and that it violate[d] principles of equity" (Pet. App. C29), pointing out that petitioner, as mortgagee, was "in the best position to provide notice to the government" and thereby to extinguish the tax lien (*id.* at C34). The court noted that, if an innocent third party had purchased the property at the first foreclosure sale, that third party would have taken the property "subject to" the federal tax lien by virtue of petitioner's noncompliance with Section 7425(b)(1). "[E]xperienced mortgagees" like petitioner, the court concluded, "certainly should not receive different treatment" when they purchase foreclosed-upon property themselves (Pet. App. C34-C35).

2. The court of appeals' decision is correct and is in accord with the decisions of every other court of appeals that has considered the question. Congress enacted Section 7425 in 1966 (Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 109, 80 Stat. 1141) in response to this Court's opinion in *United States* v. *Brosnan*, 363 U.S. 237 (1960). The Court there held that, if state law permitted it, a senior lienor could extinguish a junior federal tax lien by conducting a nonjudicial foreclosure sale without notifying the United States. Believing that the government's interests were not adequately protected in such circumstances, Congress enacted Section 7425 to govern the discharge of junior federal tax liens. Section 7425(b)(1) provides that, when

notice of a nonjudicial sale is not provided to the IRS, the sale shall "be made subject to and without disturbing [the federal tax] lien." The legislative history confirms that, in the absence of notice, the government may enforce its lien against the property in the hands of the person who purchases it at the foreclosure sale. See H.R. Rep. 1884, 89th Cong., 2d Sess. 72 (1966).

Now that the Eleventh Circuit has reversed the district court's judgment in this case, judicial authority is once again uniform as to the proper interpretation of Section 7425. That uniform view is that, if the United States is not given notice of a nonjudicial sale, the federal tax lien encumbers the property in the hands of the purchaser and, as between the purchaser and the United States, the United States comes first. *E.g., Myers* v. *United States*, 647 F.2d 591 (5th Cir. 1981); *Baldwin County S&L Ass'n* v. *United States*, 81-2 U.S. Tax Cas. (CCH) ¶ 9619 (S.D. Ala. 1981); *Puls* v. *United States*, 387 F. Supp. 760 (N.D. Cal. 1974); *Gilliland* v. *United States*, 47 A.F.T.R.2d (P-H) ¶ 81-589 (M.D. Tenn. 1981). See *Little* v. *United States*, 709 F.2d 517 (9th Cir. 1983); *Baum* v. *United States*, 76-1 U.S. Tax Cas. (CCH) ¶ 9208 (2d Cir. 1975). And this is so regardless of whether the purchaser at the foreclosure sale is an innocent third party (as in *Myers* v. *United States, supra*) or a former mortgagee of the property (as in the instant case and *Baldwin County S&L Ass'n* v. *United States, supra*). While arguing that the court of appeals' interpretation of Section 7425 is wrong (Pet. 12, 23-24), petitioner fails to address the uniform line of judicial authority in support of the decision below. Indeed, petitioner makes no claim that there is a conflict among the circuits on the question presented.

3. In challenging the correctness of the decision below, petitioner appears to have abandoned the argument on which the district court relied in granting it summary judgment—*i.e.*, that the "second foreclosure was successful

in cutting off [the government's] tax lien" (Pet. App. A9). Petitioner, in other words, seems to accept the court of appeals' conclusion that it would be "impossible for [petitioner] to conduct a second correcting foreclosure sale" (*id.* at C29) by purporting to buy property that it already owned. Petitioner challenges the decision below, rather, on the broader ground that the effect of its failure to notify the IRS of the first foreclosure was to render that sale "ineffectual and invalid" (Pet. 25), thereby returning petitioner and the IRS to their status quo ante the sale. Since the IRS's tax lien before the sale attached only to the Fergusons' equity of redemption, petitioner argues, the effect of its failure to notify the IRS under Section 7425 was not to subject petitioner's fee interest in the property to the government's tax lien, but was merely to cause "the [g]overnment's *equity of redemption* [to] continue[] after foreclosure" (Pet. 24-26 (emphasis in original)).

Petitioner's argument is squarely at odds with the plain language of the statute, with the uniform line of judicial decisions discussed above, and with the pertinent provisions of Alabama law as interpreted by the court of appeals. Section 7425 does not say that failure to notify the IRS nullifies a nonjudicial sale; the statute says, rather, that the nonjudicial sale in such circumstances "shall * * * be made subject to and without disturbing [the tax] lien" (I.R.C. § 7425(b)(1)). As we have noted, the courts of appeals have uniformly construed this statutory language to mean that the effect of a mortgagee's failure to notify the IRS is that the tax lien survives and encumbers the property in the hands of the purchaser—precisely the conclusion reached by the court of appeals here. And petitioner's argument that the effect of noncompliance with Section 7425 is merely to have "the [g]overnment's equity of redemption continue[] after foreclosure" (Pet. 25) ignores the pertinent provisions of state law. As the court of appeals held (Pet. App. C26-C29), a foreclosure sale under Alabama law results in a

complete merger of title; there accordingly exists no "equity of redemption" that could "continue after foreclosure." To the contrary, a foreclosure sale under Alabama law "vest[s] the fee simple title to the property in the mortgagee[]," and it is to that fee simple interest that the surviving federal tax lien must necessarily attach. Petitioner acknowledges, as it must,[2] that merger of title is "a generalized concept in Alabama" (Pet. 16), but argues somewhat confusingly that the court of appeals nevertheless "misinterpret[ed] the weight of the law with respect to the doctrine of merger as applied to cases similar to the present [case]" and so "misapplied Alabama law" (Pet. 17). That contention would not merit this Court's review even if it were correct, which it is not.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

CHARLES FRIED
Solicitor General

MAY 1986

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[2]See, *e.g.*, *Baldwin County S&L Ass'n* v. *United States*, 81-2 U.S. Tax Cas. (CCH) at 88,065; *Muscle Shoals Nat'l Bank* v. *Hallmark*, 399 So.2d 297 (Ala. 1981); *Trauner* v. *Lowrey*, 369 So.2d 531, 534 (Ala. 1979); *Mobley* v. *Brundidge Banking Co.*, 347 So.2d 1347, 1352 (Ala. 1977); *Oden* v. *King*, 216 Ala. 504, 508-509, 113 So. 609, 612 (1927).